State of Louisiana

J. "MIKE" FOSTER, JR.
GOVERNOR

JACK C. CALDWELL
SECRETARY

DEPARTMENT OF NATURAL RESOURCES

October 28, 1996

Mr. David Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Program
Post Office Box 25165
Mail Stop 3101
Denver, Colorado 80255

Via Telecopier (303) 231-3194
and Regular Mail

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RECEIVED

Re: Comments Concerning Proposed Amendments
to Transportation Allowance Regulations

Dear Mr. Guzy:

The State of Louisiana, through the Department of Natural Resources and the State Mineral Board (State), receives significant amounts of gas royalties from Federal lands that lie within the State and lands lying in the "8G" zone. Therefore, Federal regulations relating to the valuation of gas produced from those lands have a fiscal impact on the State.

The Minerals Management Service (MMS) has asked that commentors provide comments on the proposed amendments to transportation allowance regulations. MMS states in its preamble that amendments have become necessary due to the Federal Energy Regulatory Commission's (FERC) actions in unbundling costs in Order "636". The State agrees that this action is necessary and agrees with MMS's theory that certain costs should be allowed where the lease so provides as they are clearly transportation-related and that certain costs should be disallowed as they are not transportation-related.

Presumably the largest element of allowed transportation charges is the "firm demand charge." Lessees (in this context, lessees who pay transportation fees to pipelines) contract with pipelines and buy up a guaranteed monthly capacity entitlement (lessee is guaranteed that pipeline will transport up to that amount every month as opposed to interruptible service where the pipeline will transport volumes only if space is available). MMS proposes that the allowed monthly transportation charge will be the per MMBTU rate that is contracted for whether the lessee utilizes the total capacity bought up or not. The State agrees with MMS's determination.

Although the shipper's per MMBTU rate paid may possibly be greater than the rate per MMBTU contracted (due to shipping less volumes through the pipeline than contracted for), the State should not be liable for the additional costs incurred for the following reasons. First, the lessee has avenues available to mitigate his "losses" for unused capacity. For example, he may sell his unused capacity on the open market, possibly at prices equal to or above what he bought it for in the first place. For administrative simplicity, any gains or losses incurred in selling unused capacity should not be borne by the lessor. To allow the lessee to charge the State his actual costs and then pass on any recoupment on underutilized costs would involve an administrative nightmare both for the lessee and the State and MMS.

Secondly, the State should not be liable for marketing mistakes caused by the lessee overbuying capacity. The lessee should be required to abide by a standard of reasonable prudency and bear any unrecouped losses incurred by marketing mistakes on his own.

The State also agrees that penalties incurred by lessees (such as "cash-out," "scheduling," "imbalance," and "curtailment or operational flow order" penalties) should be borne by the lessee for the same "reasonably prudent" argument used above. Also, as MMS points out in its preamble, there are numerous mitigation tools available to allow lessees to minimize/avoid these penalties. Additionally, flow through of partial penalty recoupments would be an administrative nightmare.

The State strongly disagrees with the MMS's position regarding inclusion of Gas Supply Realignment costs (GSR) as being a deductible transportation cost. These costs relate to monies paid out by pipelines to reform or terminate gas contracts. A pipeline may pay "x" millions of dollars to lessees to get out of gas purchase contracts. That pipeline can then include those costs paid in its Firm Demand and Commodity components of its transportation rate structure. MMS proposes that this portion of the shipper's transportation rate be an allowed cost.

Lessees in general have resisted paying royalty on the contract reformation or termination payments they receive. To allow lessees to deduct those payments (when the pipeline charges the same payments back to various lessees) creates a situation where lessees literally can have their cake and eat it too. The State recognizes that current MMS policy is to have lessees pay royalty on these contract reformation/termination monies (to the extent those payments can be tied to future production) but the current status of litigation favors lessees. To the extent that lessees receive more dollars in contract settlements (that they do not pay royalty on) than they are charged in GSR costs (that they are allowed to deduct) this clearly violates the gross proceeds rule.

To remedy this demonstrably unfair situation, the State offers the following. For lessees who agree to pay royalty on contract settlement/termination monies received, the MMS would allow GSR costs as allowable deductions. For lessees who did not receive contract settlement monies, they would be allowed GSR costs as deductions since they would not be in violation of the gross proceeds rule. If subsequent appeals of the current unfavorable (to the government) court case results in the MMS prevailing, GSR costs would be allowed across the board.

Regarding the remainder of MMS's decisions to allocate costs to allowed or unallowed categories, the State is in agreement with MMS's allocation. Also, the State is in agreement with MMS's amendments to valuation regulations (necessitated by the FERC 636 Order) for "cash-out" programs.

With these provisos considered, the State generally supports efforts by the MMS to amend the transportation allowance regulations, and appreciates the opportunity to comment on same.

Sincerely,

Jack Caldwell

Jack C. Caldwell
Secretary

JCC:IJ:sm

cc: Mr. Gus Rodemacher
Ms. Sandra Bailey
Mr. David Darouse
Warren Fleet, Esq.